

# The Regulation of Credit: the new national landscape

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## Introduction

The provision of credit has long been a vexed issue. From religious prohibitions on usury and Shakespearean warnings about "*neither a borrower nor a lender be*" to more contemporary predilections to plastic money and soaring debt, credit is an important aspect of many people's lives.

The industrial revolution shaped the fabric of Europe, which resonated throughout the rest of the world. Producers were increasingly dislocated from consumers who used their income from labouring to purchase what they needed. Borrowing also evolved from a localised agreement to a contract where borrower and lender were separated spatially and financially from very different worlds.

Centralised financial institutions challenged the relevance of caveat emptor – buyer beware is not so relevant in the context of an individual consumer and their relationship with a powerful bank.

The pervading laissez faire philosophy of the 1800s characterised by minimal state involvement in private matters did not adequately protect consumers. Common law and statutory protections, which developed throughout the 20th century, reflected the vulnerability of consumers.

A holistic view of consumer protection by the 1970s identified Australia as one of the more progressive nations. Lamentably the benchmark for best practice established decades ago was not maintained and Australia has increasingly lagged behind the standards expected of a contemporary, enlightened, socially responsible nation.

## The National Credit Code

The provision of credit affects tens of thousands of consumers and the stakes may be particularly high where substantial debt is involved.

Moreover the supply of credit invariably involves unequal bargaining power between the individual consumer and the often-large corporate lending institution.

In December 2009, the Commonwealth government in conjunction with the states introduced a reform package designed to overhaul credit laws throughout Australia. *The National Consumer Credit Action Plan* commenced on 1 July 2010 and implements a uniform approach to the regulation of credit bringing the framework of protection into the 21<sup>st</sup> century.

Phase 1 of the Plan consists of:

- *The National Consumer Credit Protection Act 2009 (Cth)* (NCCP Act) and
- *The National Credit Code (NCC)*

Phase 2 (not yet implemented) will consider a review of credit cards, the regulation of credit for small business and further measures to address unfavourable lending practices.

## Key elements of the NCCP

The National Credit Code (NCC) replaced the consumer credit codes of each State.

This means there is one unified and consistent framework for consumer protection throughout Australia. The NCC applies to any provider of financial services or advice within Australia.

### *National Licensing*

The NCC establishes a national licensing of consumer credit and credit-related services. A feature of the regulation is that all credit providers and those giving advice must obtain a licence from the Australian Securities and Investment Commission (ASIC). ASIC has become the national regulator of the new credit framework with enhanced enforcement powers.

Vitality, in terms of consumer protection, to be issued a licence the provider is subject to an assessment process by ASIC to ensure they are competent.



Moreover, ASIC will have the power to suspend or cancel a licence, place conditions on providers or ban a person from engaging in credit activities.

### What does this mean for consumers?

Consumer credit practices brought under the act include home loans, personal loans, credit cards, consumer leases, line of credit accounts and investment in residential properties. The range of services provides comprehensive protection for consumers of credit in areas that previously were not effectively regulated. National regulation avoids previous jurisdictional issues and the mosaic of regulations that was problematic for both consumers and finance suppliers.

The effectiveness of the assessment process in determining whether to issue a licence is open to conjecture. ASIC does not necessarily have an unblemished record as a corporate regulator. Nevertheless national oversight should provide a degree of rigour previously lacking.

Short-term credit, less than 62 days, is generally governed by the new provisions unless the total value of the fees and charges is less than 5% and of themselves not exploitative. The provisions apply to linked credit such as that provided through car yards and white goods retailers.

The NCC does not apply to traditional pawnbroker business where the only security on the money lent is the goods that are pawned. However, pawnbrokers who in effect provide loans in which the borrower does stand to lose more than a particular chattel upon default of the loan are covered by the code.

This codifies the case law in this area where courts would not allow pawnbrokers to circumvent the protections of state based consumer credit codes.

### Responsible lending

The NCC requires licensees (credit providers) to observe a number of general conduct requirements centred on responsible lending practices. In particular this includes that suppliers take account of the consumer's ability to meet the proposed credit obligations

The key theme here is responsible, honest and fair lending. Of course such terms often require clarification – previously expensively determined through the judicial process. Clearly the onus is on lenders to only extend credit to potential borrowers if they ascertain it is reasonable and fair given the personal circumstances of the individual person.

This means that the provision of credit must be determined on a case-by-case basis with due care and diligence regarding the circumstances of the borrower.

The External Dispute Resolution process (outlined below) should provide a practical application of the terms "responsible", "honest" and "fair".

There are specific hardship provisions where the borrower has the right to request adjustment to repayments under the code. ASIC can also request such amendments.

### What does this mean for consumers?

The responsible lending requirements extend the existing obligations on credit providers to ensure that borrowers are able to service their loans. Presumably the external economic conditions at the time will be relevant in such a determination as well as the individual borrower's circumstances. The degree of probity required of lenders is quite high – it is their responsibility not to lend to people who cannot afford it.

The introduction of the Credit Act Amendments 1996 which created the Consumer Credit Code led to a significant revision of lending practices. Those changes prompted the industry to undertake a comprehensive review of their procedures and take a holistic look at best practice. It is anticipated that the NCC will have a similar impact. In theory much of the change in mindset needed to encourage large institutions to realise the onus is on them to ensure borrowers can meet repayments should have already been done.

Nonetheless the new provisions reinforce this obligation and codify it across the nation. To this end, suppliers of credit are now obliged to purchase a compliance certificate and to ensure best practice is incorporated into their operations in providing credit to consumers. The import of the responsible lending requirements and the compliance regime should further help to weed out scrupulous and unconscionable practices.

### External Dispute Resolution

A crucial aspect of the NCC mandates membership for all licensed suppliers of credit and credit-related brokering services and advice to an external dispute resolution (EDR) body. EDR organisations, although funded by the industry, are independent and governed by a board of industry and consumer representatives.



The role of EDR is to provide a cost effective mechanism to resolve credit disputes. The Consumer Trader & Tenancy Tribunal no longer settles credit matters but State and Federal courts do have jurisdiction. The Local Court and Federal Magistrates Service give consumers the option of opting into a court based determination with limited cost or risk of appeals. The expectation is that the courts will determine only matters involving systemic issues affecting a large number of consumers or very complex matters.

The consumer can always refer the matter to ASIC, which will be involved if there is evidence of a widespread public interest issue. ASIC can seek civil or criminal penalties under the legislation through the courts, which further promotes compliance to the legislative provisions.

The EDRs available:

1. The Financial Ombudsman Service (FOS). The FOS operates under the auspices of ASIC and replaces the Banking and Financial Services Ombudsman, which is in effect now a division of the FOS along with General Insurance and Investments, Life Insurance and Superannuation divisions.
2. The Credit Ombudsman Service Ltd, which has a similar function to the FOS.

### What does this mean for consumers?

Consumers of course require adequate access to dispute resolution that is cost and time efficient, and the EDR provides this. The essence of the issue in relation to credit disputes is the power imbalance between providers and individual consumers. The concern is that the EDR scheme may actually exacerbate inconsistent dispute handling, as each case will necessarily have a particular unique set of circumstances. Credit providers are concerned about the potential sully of their reputations by overly vexatious complaints by consumers who have little to lose by initiating proceedings.

The EDR scheme will commonly deal with breaches of the NCC's responsible lending practices, applications under the hardship provisions or applications that a contract is unjust. Applications to EDR under the NCC are free for consumers and while the matter is under EDR a creditor cannot proceed against a borrower in court.

The process is a written rather than oral one – resolution is determined by factual analysis by the dispute resolution body rather than oration, which obviates the need for legal

representation. The focus of EDR is to encourage negotiation and agreement. The board of the EDR body comprises representatives of credit suppliers whose best interests are served by an honest and efficient industry while consumer advocates on the board have consumer protection as their primary concern.

### Review Questions

1. Explain the rationale behind the NCC provisions.
2. Examine the legislative changes which have introduced the NCC. Assess their effectiveness in protecting consumers.
3. How effective is ASIC's role in protecting consumers from unfair lending practices?
4. With reference to one EDR explain how it promotes compliance and helps to resolve disputes.
5. Examine how the regulation of credit reflects the values and ethics of contemporary Australian society.
6. Visit the following websites for more information:
  - [www.asic.gov.au](http://www.asic.gov.au) (go to "What's New")
  - <http://fos.org.au> (go to cases, then case studies, then banking and financial services)
  - [www.cosl.com.au](http://www.cosl.com.au)

[Sources: Fair Trading NSW website, *The National Consumer Credit Protection Act 2009 (Cth)*, K. Cox, *Hot Topics* 72, 2010]

[Syllabus link – Preliminary Course *The legal system – Law reform in action; Law in practice.*

HSC Course *Consumer – Principal focus; Themes and challenges; The nature of consumer law; Consumer redress and remedies; Contemporary issues concerning consumers – credit]*

This article can be discussed within the following "themes and challenges"

- the role of the law in encouraging cooperation and resolving conflict in regard to consumers
- issues of compliance and non-compliance
- laws relating to consumers as a reflection of changing values and ethical standards
- the role of law reform in recognising the rights of consumers
- the effectiveness of legal and non-legal responses in achieving justice for consumers.